

## AREAS OF RECURRING TAXPAYER NONCOMPLIANCE

### RETURNS PROCESSING CENTER (RPC)

*The primary goal of the Returns Processing Center is to insure that all returns and payments are received, processed and posted in a timely and accurate manner. New technology is constantly being developed to facilitate this process. Although the Department receives a greater number of returns and payments electronically each successive year, it still processes over six million paper returns for 43 different tax and fee types -- and, it continues to have problems with the following areas of recurring taxpayer noncompliance.*

#### Use of Non-Department Payment Coupons

Each year the Department provides preprinted coupon vouchers to taxpayers who are registered with the Department and have a previous history of filing coupons. Relevant tax types include: sales tax, withholding tax, estimated tax for both individuals and corporations, and various other taxes and fees. Each month, the Department receives several thousand payments without coupons, some with handwritten information on pieces of paper, coupons from prior filing periods with handwritten changes to fit the time periods for which the taxpayers are trying to file, or payments with no explanation at all. In addition, the Department receives numerous coupons generated by tax preparation software that cannot be processed by its automated equipment. These coupons have to be manually processed, which takes longer and causes payments to taxpayers' accounts to be delayed.

#### Post Filing Coupon (PFC)

The following is a list of recurring problems the RPC encounters during the processing of the Indiana PFC that foster the erroneous issuance of tax notices and hinder the Department's ability to process payments quickly and accurately. (The PFC is used for the payment of additional tax on the Indiana Individual Income Tax Return.)

- 1) In order for scanning equipment to properly recognize taxpayers and the amount of payments, coupons must have the dollar amount and scanline in an "OCR-A Extended" font. Department personnel have noticed that the scanlines on coupons from at least three software vendors do not include the required font. Those software companies say that users (tax practitioners) are not downloading the font when they download the documents for printing. The Department has suggested that software companies "hard code" the required font into their documents for the scanline and dollar amount.
- 2) The Department has suggested that the software companies make the PFC available for all Individual Tax Forms, both paper and electronically-filed. It has also suggested that tax practitioners include the post filing coupon to speed up processing, whether payments are included with the return or submitted separately.

#### Failure to Complete All the Required Lines/Information

The Department receives numerous returns that are incomplete, which greatly delays the returns' processing. Department personnel must either complete the returns based on information provided, contact the taxpayers, or mail the returns back to the taxpayers for additional information. All of these options hinder the Department's ability to process returns quickly and efficiently.

#### Duplicate Returns

Some taxpayers file returns electronically but then file paper copies of the same returns with the Department, thus creating duplicate returns. The second returns received by the Department's computer system will "suspend," which means they must be reviewed individually by tax analysts, who have to make determinations on how, or if, the second returns should be posted to taxpayers' accounts.

#### Filing the Wrong Return

The Department receives numerous returns each year which are either 1) on the correct forms but for the wrong year, or 2) on the wrong forms but for the correct year. An example would be taxpayers' submitting IT-40EZ forms, even though they do not qualify for that form because of their type of income or deductions. In these cases, Department employees must determine the correct forms to be used and either attempt to transfer the

information to the correct forms, or return the incorrect forms to the taxpayers, along with copies of the correct forms for resubmitting.

Taxpayers who are residents of reciprocal states often file on Indiana Form IT-40 and take deductions of the other states' incomes, rather than filing the appropriate Indiana Form IT-40RNR (Reciprocal Nonresident).

#### Failure to Attach W-2 Forms

The Department receives a vast number of Individual Income Tax returns without W-2 forms to verify the withholding taxes taken as credits on the returns. Failure to submit W-2 forms causes the returns to be rejected and returned to taxpayers with requests for correct documentation.

#### Failure To Attach W-2 Forms with the WH-3

The WH-3 is a reconciliation of the W-2 forms for employers; both the WH-3 and all W-2 forms must be submitted together annually. The Department often receives WH-3 forms without W-2 forms attached. It also often finds cases of taxpayers changing business names during the year but continuing to file their taxes under their previous Identification Number, and then using the incorrect forms at the end of the year to submit their withholding information for the year. Although the Department provides for the filing of WH-3 and W-2 forms using magnetic media, few taxpayers take advantage of this technology.

#### Failure to Attach the Necessary Schedules

The Department finds that taxpayers often take deductions or credits on their tax returns, but fail to include documentation or necessary schedules to substantiate the deductions or credits being taken (e.g., College Credit, Form CC-40).

#### Failure to Comply with Enterprise Zone Deduction

Taxpayers who live in Enterprise Zones and work for qualified employers in those zones may be qualified to take the Enterprise Zone Deduction. The deduction is one-half (1/2) of the earned income shown on Form IT-40QEC, or \$7,500, whichever is less. Often the deductions are calculated incorrectly, or Form IT-40QEC, which should be completed and submitted by the employers, are not attached to the taxpayers' Forms IT-40.

#### IT-9, Extension Payment Voucher

Taxpayers file Form IT-9, even though no tax is due; or, they file the form, showing taxes due, but fail to include a payment.

#### Penalty for Underpayment of Estimated Tax

Taxpayers who don't have taxes withheld from their income and/or don't pay sufficient estimated taxes throughout the year often owe penalties for underpayment of estimated taxes. Generally speaking, taxpayers who owe \$400.00 or more in state and county taxes for the year but do not have taxes withheld from paychecks need to make estimated tax payments during the year.

#### Failure to Calculate County Tax

Often taxpayers fail to compute their county taxes. If, on January 1 of the tax year, taxpayers lived and/or worked in Indiana counties that have such taxes, they must figure their county taxes. Failure to calculate county taxes due may delay processing of their returns.

#### Improper Completion of County Boxes

Some IT-40's are received with "00" inappropriately marked in the county boxes. (An example is "00" entered in the spouse boxes for a single taxpayer.) The Department's computer system recognizes "00" as meaning a non-reciprocal, out-of-state county.

#### Fuel Tax -- Common Reporting Errors

A review of previously-filed special fuel and gasoline monthly tax returns has revealed the following most common reporting errors (on Forms FT-1, SF701, MF360, SF900, SF401, MF600, SF801, SF-IVP and FT501, and Schedules 1A, 2A, 3A, 5 through 10, 501A, 501B and 501I):

- Return submitted without license/account number
- Return submitted without signature of person completing/filing return
- No payment submitted with a return that indicates an amount due
- Payment submitted but no return filed
- Missing schedules
- Incomplete information provided on schedules
- Transactions reported in the wrong month (All special fuel transactions must be reported in the month in which they occur.)
- Duplication of deductions on more than one schedule
- More than one fuel type reported on same schedule
- Export schedules not filed in duplicate as required
- Dyed fuel transactions reported on schedules designated as clear fuel
- Deliveries of special fuel with an Indiana destination misreported on export schedules
- Truck deliveries misreported on Schedule 6
- Computer generated forms/schedules that do not conform to Department requirements
- Not filing schedule correctly for dyed fuel use

#### Environmental Tax -- Common Reporting Errors

A review of previously-filed environmental returns has revealed the following common reporting errors (on Forms UST-1, HC-500, HW-020 and SW-100):

- Forms not signed
- No Federal I.D. Numbers/Social Security Numbers
- No checks with forms
- No forms with checks
- Payment amounts are different than amounts due
- Missing schedules
- Duplicate filing

#### Trust Taxes – Retail Sales and Use Tax and/or Withholding Tax

-Taxpayers fail to complete the entire ST-103 return and /or WH-1 and the annual WH-3. Each month, the Department receives thousands of incomplete returns. These returns cannot be automatically processed and are “suspended” until they can be manually reviewed, corrected, and posted to taxpayer accounts.

-Taxpayers do not use their complete Indiana Taxpayer Identification Numbers (TID Number) on forms and in correspondence. Indiana Taxpayer Identification Numbers use the 10-digit TID Numbers with the three-digit location number and do not drop leading zeros. Our processing system requires all 13 digits. If taxpayers have coupons with 10-digit TID Numbers, the three-digit location number, and then a single-digit, they may drop the 14<sup>th</sup> digit.

-Taxpayers send in photocopied returns being used for other time periods or other taxpayers. The information in the scanlines on preprinted returns determine where that return is credited or posted. Thousands of returns each year are improperly posted due to this error, and invalid liability notices are issued to taxpayers.

-Taxpayers are not using the Change Form if their business locations have closed and the business registration at the Department needs to be permanently closed. This form is included in the coupon booklet. Taxpayers need to check the box located under the space for telephone number and enter the close date. This would be used if that specific location has PERMANENTLY CLOSED (no longer in business). This should not be used if closing temporarily (such as a seasonal business).

-On business tax applications, taxpayers should be sure to include their township information. This information is required; the form cannot be processed without it. Township information is used by the Department to comply with annual Departmental reporting requirements.

-When filing amended returns, taxpayers are not clearly marking the top of the form to state “AMENDED” returns.

### Corporate Income Tax

-When claiming withholding credits on IT-65 or IT-20S, taxpayers are not attaching the WH-18's to income tax returns as verification of the credits claimed. Credits without this verification cannot be allowed.

-Taxpayers are not answering the question — "Is an extension of time to file attached?" — on their Indiana corporate returns (e.g., IT-20, IT-20S, IT-65) when state or federal extension forms are attached.

### Electronic Funds Transfer (EFT)

-EFT taxpayers are not in compliance with the recap filing requirements when they do not file quarterly recaps. Failure to comply may result in delinquency notices issued to taxpayers.

-Some EFT filers do not understand that remitting by EFT does not change due dates of tax payments.

-Once registered for EFT filing, taxpayers receive quarterly recaps and assume their due dates are now quarterly. Filing quarterly results in penalties and interest assessments for the first two months of the quarter.

### Electronic Filing

The Department is still receiving hundreds of Indiana Form IT-8453 mailed in by the Electronic Returns Originator (ERO) or by the taxpayer. For the Federal/State E-File Program, Indiana requires that this form be kept and maintained by the ERO. For both the Federal/State On-Line Filing Program and the Indiana I-File Program, the form is to be kept and maintained by the taxpayer.

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## **COMPLIANCE DIVISION**

### AERONAUTICS/TAX CLEARANCES SECTION

The Aeronautics Section mailed 5,120 aircraft registration renewals for the calendar year 2002 with 155 owners in delinquent status as of December 2002. This translates into a 97% renewal compliance rate which is an increase of three percent in compliance over last year.

Indiana Code 6-6-6.5-2 states that any Indiana resident who owns an aircraft must register the aircraft within thirty-one (31) days from the purchase date. Any nonresident who bases an aircraft in this state for more than sixty (60) days shall register the aircraft with the Department no later than 60 days after establishing a base in Indiana.

### Corporate Dissolutions, Reinstatement Certificates of Clearance, Grant Clearances and Letters of Good Standing

This section has received 3,306 notices of corporate dissolution. Indiana Code 6-8.1-10-9 provides that any corporate officer or director becomes personally liable for all taxes, penalties, interest, and fees associated with the collection of liabilities for a period of one year from the date the Department is notified of the corporation's dissolution. The corporate officers or directors become personally liable because the dissolving corporation distributed corporate assets before all liabilities were satisfied. Corporate officers or directors may be absolved of any personal liability by obtaining a Certificate of Clearance from the Department. The Certificate of Clearance certifies that all liabilities due the Department have been satisfied.

Corporations that are administratively dissolved by the Secretary of State's office for noncompliance must obtain a Reinstatement Certificate of Clearance from the Department verifying the corporation is in good standing before they can be reinstated with the Secretary of State. The Department issued 1,777 Certificates of Clearance and denied or closed 574 requests due to outstanding issues.

Corporations in the process of obtaining financial loans or other state agency grant or award approval will request a Letter of Good Standing. The Department has issued 588 Letters of Good Standing and denied 251 requests due to missing returns or unpaid liabilities.

Over 4,500 Responsible Officer Billings were generated for trust taxes not paid by the corporation representing

a total due of \$8,104,178. Fifty-seven percent of the responsible officer billings were created for the Audit Division-Operation Street Sweep Project.

### **BANKRUPTCY SECTION**

The bankruptcy section reviewed 50,034 Chapter 11, Chapter 7 and Chapter 13 bankruptcy notices to determine if holds needed to be placed on outstanding liabilities to prevent the Department from being in violation of the automatic stay and to see if a claim needed to be filed with the bankruptcy court based upon outstanding liabilities and/or non-filed tax returns. Of the notices reviewed, claims were filed totaling \$241,047,533.30. Of the preexisting cases, claims were amended reducing the assessments by \$152,106,728.19. This makes the net assessments for the fiscal year ending June 30, 2003 \$88,940,835.11.

The bankruptcy section received and processed 7,063 payments totaling \$15,271,391.75. Of the payments received, 861 included additional interest totaling \$57,537.26.

This area also handled 12,789 incoming phone calls as well as 151,992 pieces of incoming correspondence. The section received and processed 4,157 previously unfiled tax returns due to bankruptcy proceedings.

The function of billing responsible officers was part of the bankruptcy section until mid-January during the fiscal year ending June 30, 2003. During this time, 14 responsible officers were billed for a total of \$1,503,804.79.

(See graphs on Bankruptcy Claims Filed, Gross Value of Claims and Collections on Pages 74-76.)

### **INDIVIDUAL/WITHHOLDING/CORPORATIONS TAX SECTION**

The Individual Income Tax Section's mission is to identify and pursue non-filers, as well as to verify the accuracy of filed returns by utilizing information from the Internal Revenue Service, various Indiana State agencies, other state taxing agencies, and anonymous informants. The standard compliance projects and findings for Fiscal Year 2003 are as follows:

#### **Federal Audits**

Information is obtained from the Internal Revenue Service concerning agreed federal tax audit reports to the Department. If taxpayers do not amend their Indiana Individual and Corporate income tax returns to report the Indiana adjustments resulting from the federal modifications detailed in the audit findings, a tax assessment is generated. For this fiscal year, 134 corporate taxpayers were billed for an amount of \$2,207,928.00 and 1,213 individual taxpayers for \$1,571,768.74.

#### **CP2000 Unreported Income**

The Department obtains data from the Internal Revenue Service regarding taxpayers who failed to report all taxable income. This could be income derived from wages, interest, dividends, or non-employee compensation. These types of income are reported on W-2's or Form 1099 information returns. An assessment is generated if the income was not reported on the original return. The project resulted in 7,181 taxpayer assessments for an amount of \$2,898,150.00

#### **Federal/State Crosscheck**

The Department obtains magnetic tape information from the Internal Revenue Service disclosing adjusted gross income and exemptions reported on the federal returns. This file is compared to the state reported adjusted gross and exemptions from our master file. Automatic billings are then generated for any state and county tax due on the differences. This project resulted in 12,228 taxpayers being assessed for an amount of \$4,128,954.00.

#### **Withholding Discrepancies**

A comparison is made between taxpayers' annual WH-3 Forms with the state and county withholding payments (from Form WH-1) made during the year. If underpayments exist, taxpayers are assessed the differences. The project resulted in 95 taxpayers being assessed for an amount of \$1,561,535.00.

#### **Individual Desk Audits**

Individual desk examinations are performed, based on anonymous sources or submissions from other divisions within the Department. The examination may consist of verifying income reported, credits/deductions taken, or

the amount of refund requested. Individual desk audit resulted in 390 assessments of \$457,386.00.

#### Voluntary Compliance Program

Taxpayers, who discover that they may have nexus with Indiana, but have not filed returns, frequently contact the Department and request to enter into a Voluntary Compliance Agreement. These taxpayers are often confused or unaware of filing requirements for income tax and sales/use taxes in Indiana. Tax due is not forgiven, nor is interest abated. Forty-eight (48) Voluntary Compliance Agreements were entered into for the fiscal year ending June 30, 2003, resulting in tax collected of \$3,158,329.00 and additional liabilities totaling \$690,222.00.

#### Riverboat Project

The Department of Revenue obtained information on Indiana riverboat winnings received during 1999 and 2000 from federal Form W-2G (Certain Gambling Winnings). Approximately 25,000 letters were mailed to those winners who did not report this taxable income to the State of Indiana, resulting in \$1,759,400 additional tax revenues being collected in Fiscal Year 2003. This project will continue to target riverboat gambling payouts made during 2001 through June 30, 2002, after which time new legislation began requiring state income taxes to be withheld at the time of payout.

#### Neighborhood Assistance Program

The total Neighborhood Assistance credits allowed in a fiscal year (July 1 to June 30) can not exceed \$2.5 million. The Indiana Department of Commerce verifies donations made to qualified Neighborhood Assistance Organizations. The Department of Revenue tracks the donations from various business entities allowing 50% of the allowable donation as a credit against gross income tax, adjusted gross income tax, or supplemental net income tax. The Department has processed 3,729 tax credits for the fiscal year ending June 30, 2003.

#### **NONPROFIT/CHARITY GAMING/FIDUCIARY TAX SECTION**

This section is responsible for determining organizations' nonprofit status and for licensing qualified nonprofit organizations for bingo, festivals, raffles, door prizes and charity gaming nights. This section also licenses manufacturers and distributors to sell tip boards, punchboards and pull-tabs.

A total of \$4,102,375.00 in gaming fees were collected from the following licenses issued:

Annual Bingo	901
Charity Game Night	187
Door Prize	7
Festival	298
Raffle	627
Special Bingo	<u>164</u>
Total Licenses Issued	2,184

The following gaming license fees were collected:

Gaming License Fees	\$4,102,375.00
Manufacturers License	\$ 42,000.00
Distributors License	<u>\$ 116,000.00</u>
Total Fees Collected	\$4,260,375.00

During Fiscal Year 2003, the Charity Gaming Section conducted three training seminars, which were held in Plymouth, Indianapolis, and Madison. Approximately 337 representatives from nonprofit organizations attended these seminars, which covered the following topics:

- Legislative Change for Not-for-Profit Organizations
- Not-for-Profit New Application
- Not-for-Profit New Annual Report
- Not-for-Profit Sales Tax Exemption
- Unrelated Business Income



Revised Nightly Summary Report  
Use of Charity Gaming Proceeds  
Registration of Unlicensed Events  
Record Keeping and Retention Guidelines  
Festivals  
Fines and penalties  
Protest and Hearing Procedures

#### Future Charity Gaming Training and Education

The Department will be sponsoring six (6) training seminars throughout the state during the next fiscal year. These seminars will be held in Madison, Indianapolis, Fort Wayne, Terre Haute, Jasper and Michigan City. The topics for these seminars will be determined at a later date.

#### Fiduciary Tax Section

This section processed 43,314 fiduciary returns from 7/1/2002 to 6/30/2003 representing a total of \$14,339.760 in tax collected.

#### **CONSUMER USE TAX, UTILITY/TRUST/FUEL/SALES REFUNDS SECTION**

Utility exemption requests for sales tax numbered 4,440 applications for the year. Approximately 3,890 of the applicants qualified for 100% exemptions on their purchases of public utility services. These applicants were primarily government, nonprofit organizations and those companies engaged in manufacturing whose use of the utility was predominately for exempt purposes.

Approximately 250 business entities, such as restaurants and industrial processors, received less than total utility exemptions. These types of entities must pay sales tax on their utility bills to their vendors and then file annual refund claims for the amounts of exempt percentages allowable. Another 300 applications for exemption were totally denied as results of desk examinations. The most common reason for 100% denials was the failure of applicants to provide adequate information to support their claims.

Approximately 982 consumer use tax bills were issued. Use tax bills were generated as a result of obtaining information on doubtful exemption users, from information received from the Audit Division, the Bureau of Motor Vehicles and from other states authorized through our exchange of information agreements. The balance were received from out-of-state companies who either owe Indiana Use Tax or have collected Indiana Sales Tax from Indiana customers, but were not legally registered.

Approximately 2,999 fuel tax refund claims were processed during the year. These claims were filed by government entities, companies and individuals that paid Gasoline Tax and Special Fuel Tax on fuel used in an exempt manner.

Almost 3,000 trust tax claims were received in the Compliance Division. Of these, approximately 70% were examined within the section. The balance of claims were forwarded to other areas for final reviews.